No. 203

In the Supreme Court of the United States

OCTOBER TERM, 1945

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

ESTATE OF HARRY HOLMES, DECEASED, LUCY B. HOLMES, INDEPENDENT EXECUTRIX

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT

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The Solicitor General, on behalf of the Commissioner of Internal Revenue, prays that a writ of certiorari issue to review the judgment of the Circuit Court of Appeals for the Fifth Circuit entered in this case.

OPINIONS BELOW

The opinion of the Tax Court (R. 18–31) is reported at 3 T. C. 571. The opinion of the circuit court of appeals (R. 65–69) has not yet been reported.

JURISDICTION

The judgment of the circuit court of appeals was entered on April 14, 1945 (R. 70). The juris-

diction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

The decedent transferred certain property in trust. The income beneficiaries were his three sons, or certain other contingent beneficiaries. The trust was to continue for a period of fifteen years, but under certain contingencies could terminate sooner. Also, the decedent reserved the power to terminate the trust at any time, and thereby to pay the corpus to the beneficiaries then entitled to receive it. Upon termination of the trust, the corpus was to be paid to the sons, if then living, and if not, to other contingent beneficiaries.

The question is whether the interests thus created were subject to any change in enjoyment through the exercise of a power by the decedent to alter, amend, or revoke, within the meaning of Section 811 (d) (2) of the Internal Revenue Code.

STATUTE AND REGULATIONS INVOLVED

The applicable provisions of the statute and Regulations involved are set forth in the Appendix, *infra*.

STATEMENT

The facts in this case were stipulated by the parties (R. 41–60), and were found by the Tax Court as stipulated (R. 19).

On January 20, 1935, the decedent transferred to himself, as trustee, 30 shares of the capital stock of the Quintana Petroleum Company to be held in trust for the benefit of his three sons and certain other contingent beneficiaries. (R. 41–42). This stock was a part of the community estate of the decedent and his wife (R. 42).

The trust provided (R. 50–52):[1]

> FOURTH
>
> During the lifetime of my son, Harry Holmes, Jr., and prior to the termination of the trust herein created for his benefit, the Trustee shall distribute the net income from the share or trust so allocated to my son, Harry Holmes, Jr., to him in convenient installments, preferably monthly; provided the Trustee may withhold distribution of any portion of said net income, should he determine it for the best interest of my said son, any portion of said net income so withheld to be accumulated for his benefit; provided, should my said son, Harry Holmes, Jr., die during the continuance of said trust and leave issue surviving, then, his share or trust shall be held for the benefit of his surviving issue, share and share alike. If such issue be over twenty-one (21) years of age, his or her share or portion of said trust shall be distributed and delivered to

[1] Paragraphs Fifth and Sixth (R. 52–56) provided, in substantially identical terms, for the interests of John B. Holmes and Thomas J. Holmes, the other named beneficiaries.

such beneficiary, and the trust, as it relates to such portion, shall thereupon be terminated. If any such issue shall be under the age of twenty-one (21) years, the Trustee shall use such portion of the net income on such beneficiary's share, or trust, as in the discretion of the Trustee may be deemed necessary or advisable to provide for such beneficiary's care, support, maintenance and education, until such beneficiary arrives at the age of twenty-one (21) years, any unused portion of said net income to accumulate for the benefit of such beneficiary. When such beneficiary arrives at the age of twenty-one (21) years, he or she shall receive the entire portion of the Trust Estate from which he or she shall have theretofore received the income.

If my son, Harry Holmes, Jr., shall die during the continuance of the trust so allocated to him, without leaving surviving issue, or if he shall leave such issue, but such issue shall die before reaching the age of twenty-one (21) years, then, in either of such events, the share or trust that would have gone to my said son, Harry Holmes, Jr., or his said issue, shall enure pro rata to my sons, John B. Holmes and Thomas J. Holmes, if living, and if not living, to their issue, such issue to take per stirpes. If either of my sons John B. Holmes or Thomas J. Holmes, should then be dead without issue, the whole of such share or trust shall enure to the survivor, or to the

issue of the other, to be administered and distributed in the same manner as hereinafter provided for the administration and distribution of the trust in this instrument created for the benefit of such surviving son, or his issue.

Should all of my said sons die without leaving surviving issue prior to receipt and distribution of all of the residue of this Trust Estate, then and thereupon, said residue shall be distributed to Grantor's wife, Lucy B. Holmes, if living, and if she is not then living, said residue shall be distributed to the persons who would be her legal heirs under the laws of descent and distribution of the State of Texas.

If, at any time during the continuance of this trust, it should be, in the opinion of the Trustee, necessary or advisable to use some portion of the principal herein set aside and allocated to my son, Harry Holmes, Jr., or his issue, as herein provided, for the maintenance, welfare, comfort or happiness of my said son, or his issue, or any beneficiary thereof, or for the education of any of such beneficiaries, the Trustee is hereby authorized and empowered to use so much of the principal as in the opinion of the Trustee is deemed necessary or advisable to meet such conditions; any principal so used to be charged to the beneficiary for whose benefit such use of principal is made when distribution is made hereunder. Grantor hereby suggests that

the Trustee be liberal in construing for the benefit of Grantor's said son or his surviving issue, any condition or circumstance that may require the use or distribution of said principal to provide for the maintenance, welfare, comfort or happiness of Grantor's said son or his surviving issue.

The trust instrument also provided (R. 58, 59):

ELEVENTH

Grantor, during his lifetime, and my son or sons herein named, while acting as Trustee hereunder, may, if deemed advisable by them as Trustee, distribute to either of Grantor's children, the whole or any part of the principal of their respective trusts, and their interests thereunder. And Grantor may, during his lifetime, if deemed advisable by him, and my son or sons herein named, while acting as Trustee hereunder, may, if deemed advisable by them as Trustee, terminate either or all of said trusts herein created for the respective benefit of my said sons, and distribute the principal of the trust to the persons entitled to receive the same under the terms hereof on the date of such termination.

* * * * * * *

THIRTEENTH

The several trusts herein created shall continue and exist and be administered by the Trustee as herein provided, (unless distributed by Grantor prior to his death, or distributed by Harry Holmes, Jr., John

B. Holmes or Thomas J. Holmes, while they are acting as Trustee, as hereinbefore provided, for the period of fifteen (15) years from this date, provided that if, at the expiration of fifteen (15) years there are beneficiaries hereunder under the age of twenty-one (21) years, the trustee [trust] shall be continued as to such beneficiaries' share or portion of such Trust Estate until such beneficiaries shall reach the age of twenty-one (21) years, or shall die, in either of which events, the trust as to such portion shall terminate, and provided further, and it is hereby made an express condition of this trust, that the same shall terminate twenty-one (21) years after the death of the last survivor of my said sons.

Upon the termination of the trust herein created or of said respective trusts, as herein provided, the entire Trust Estate then remaining in the hands of the Trustee, whether principal or accumulated income, shall be immediately divided, distributed and paid over to the persons who are entitled to receive the same in the proportions and according to the provisions of this agreement.

The Quintana Petroleum Company was liquidated on December 31, 1938, as a result of which a *pro rata* part of the assets of the company was conveyed to the decedent as trustee (R. 42). The decedent did not relinquish his duties as trustee, but continued to act in that capacity until the

date of his death, October 5, 1940 (R. 41, 42). In the estate tax return filed by taxpayer, the executrix of his estate, the property which had been transferred by the decedent to the trust was not returned as a part of his gross estate. The fair market value of a one-half interest in the trust assets was, at the time of the decedent's death, $91,593.17. (R. 42–43.)

The Commissioner determined a deficiency in estate tax because of the failure to have included in the decedent's gross estate, pursuant to the provisions of Section 811 (d) of the Internal Revenue Code, his community property interest in the assets of the trust (R. 8–15). The taxpayer sought a redetermination of the deficiency before the Tax Court. The Tax Court ruled that the property was not includible in the decedent's gross estate and decided that there was no deficiency in estate tax (R. 19–31). The circuit court of appeals, Judge McCord dissenting, affirmed the decision of the Tax Court (R. 65–70).

SPECIFICATION OF ERROR TO BE URGED

The circuit court of appeals erred in holding that the transfers made by the decedent were not required to be included in his gross estate under Section 811 (d) of the Internal Revenue Code.

REASONS FOR GRANTING THE WRIT

1. The decision below is in conflict with *Mellon* v. *Driscoll*, 117 F. 2d 477 (C. C. A. 3), certiorari

denied, 313 U. S. 579, and *Commissioner* v. *Hofheimer* (C. C. A. 2), decided May 25, 1945, not yet reported. The Tax Court undertook (R. 28) to distinguish the *Mellon* case, on the ground that there "the exercise of the power of revocation or termination meant a new conveyance of the corpus to the beneficiaries," whereas here "an exercise by the settlor of his power to terminate the trust meant only an acceleration of the time of enjoyment." We are unable to perceive either validity or significance in the purported distinction; and the circuit court of appeals placed no reliance thereon. Referring to the Tax Court's effort to distinguish the *Mellon* case, the court said merely (R. 68): "If it is not so distinguishable, * * * we decline to follow it." The decision below rests on a construction of the statute explicitly stated to be contrary to that adopted in the Third Circuit.

2. The decision below was erroneous. All the interests created by the decedent were subject to changes in enjoyment by the exercise of his retained power to terminate the trust, since the exercise of this power would have altered or amended the transfer made and the interests created thereunder. The trust instrument gave the decedent's sons, the named beneficiaries, only a present interest in the income of the trust, subject to spendthrift limitations. In the absence of action by the trustees, each of the named bene-

ficiaries had to be in existence at the time of the termination of the trust in order to acquire any ownership rights in the corpus. Also, each of the beneficiaries, including those not specifically named, had a contingent, but more remote, interest in the corpus which might ripen into ownership if one or more of the named beneficiaries should not survive the duration of the trust. Thus, until termination of the trust, it could not be ascertained who would share in the trust corpus, or how the property would be apportioned among those entitled to take.

If the decedent had exercised his reserved authority to terminate the trust, he would have transformed the contingent interests of the named beneficiaries into complete and absolute ownership. Likewise, his action in this regard would have destroyed the contingent rights of each person who otherwise might have acquired ownership rights had any of the gifts over taken effect.

All the beneficial interests created were thus subject to a change in enjoyment by the decedent's authority to alter or amend those interests and the transfer under which they were created. Since the trust at the time of his death was still subject to change through the exercise of this power, the provisions of Section 811 (d) (2) of the Internal Revenue Code (Appendix, *infra*) clearly require that the value of the prop-

erty transferred be included in the decedent's gross estate.

3. The decision below was reached by disregarding the construction of the statute made in a valid Treasury regulation. The circuit court of appeals construed the phrase "alter, amend, or revoke" in Section 811 (d) (2) as not including the authority to terminate a trust, in the manner involved here, unless the power, when exercised, be equivalent to revocation. It gave a similar interpretation to Section 811 (d) (1) of the Internal Revenue Code (Appendix, *infra*), applicable to transfers made after June 22, 1936, containing the phrase "alter, amend, revoke, or terminate." The word "terminate" was added by Section 805 of the Revenue Act of 1936, c. 690, 49 Stat. 1648, as a clarifying amendment to restate existing law. See H. Rep. No. 2818, 74th Cong., 2d Sess., p. 10. In this respect, Section 81.20 of Treasury Regulations 105 (Appendix, *infra*) provides:

> The third change made in the subdivision by the Revenue Act of 1936 (which is also embodied in subsection (d) (1) of section 811 of the Internal Revenue Code) consists of the addition of the words "or terminate" following the words "to alter, amend, revoke." Such addition is considered but declaratory of the meaning of the subdivision prior to the amendment. A

> power to terminate capable of being so exercised as to revest in the decedent the ownership of the transferred property or an interest therein, or as otherwise to inure to his benefit or the benefit of his estate, is, to that extent, the equivalent of a power to "revoke," *and when otherwise so exercisable as to effect a change in the enjoyment, is the equivalent of a power to "alter."* [Italics supplied.]

In concluding that a power to terminate a trust is covered by the statute, both before and after the 1936 amendment, only when its exercise would be equivalent to a power to revoke, the court below quoted the Regulation in support of its view (R. 68). However, its quotation was only partial; it failed to quote the portion of the Regulation which appears above in italics. The italicized portion of the Regulation plainly demonstrates that the transfer here involved must be included in the decedent's gross estate, since the power to terminate the trust could have effectuated changes in enjoyment of the interests created, and was therefore "the equivalent of a power to 'alter'."

4. So far as the court below placed importance on the fact that the decedent's retained authority could not be used to benefit himself or his estate, or to choose different beneficiaries, its decision also conflicts with *Porter* v. *Commissioner*, 288

U. S. 436, and *Millard* v. *Maloney*, 121 F. 2d 257 (C. C. A. 3), certiorari denied, 314 U. S. 636.

5. The decision in this case presents a question of importance in the administration of the estate tax law. The circuit court agreed with the Commissioner's contention that the addition of the word "terminate" by Section 805 of the Revenue Act of 1936, *supra*, was merely declaratory of existing law and did not change the meaning of the statute—although it disagreed with the Commissioner as to what that meaning was. The decision below, therefore, if not reversed, will be urged as a precedent, and in the Fifth Circuit at least will presumably be followed, in the case of similar transfers made after June 22, 1936 (governed by Section 811 (d) (1) of the Internal Revenue Code).

CONCLUSION

The decision below is erroneous. There is a conflict in decisions on a question of importance which is likely to recur. An interpretation of the statute embodied in a valid Treasury regulation has been ignored. For the foregoing reasons, it is respectfully submitted that this petition should be granted.

HUGH B. COX,
Acting Solicitor General.

JULY 1945.

APPENDIX

Internal Revenue Code:

SEC. 811. GROSS ESTATE.

The value of the gross estate of the decedent shall be determined by including the value at the time of his death of all property, real or personal, tangible or intangible, wherever situated, except real property situated outside of the United States—

* * * * * *

(d) *Revocable transfers*—(1) *Transfers after June 22, 1936.*—To the extent of any interest therein of which the decedent has at any time made a transfer (except in case of a bona-fide sale for an adequate and full consideration in money or money's worth), by trust or otherwise, where the enjoyment thereof was subject at the date of his death to any change through the exercise of a power (in whatever capacity exercisable) by the decedent alone or by the decedent in conjunction with any other person (without regard to when or from what source the decedent acquired such power), to alter, amend, revoke, or terminate, or where any such power is relinquished in contemplation of decedent's death;

(2) *Transfers on or prior to June 22, 1936.*—To the extent of any interest therein of which the decedent has at any time made a transfer, by trust or otherwise, where the enjoyment thereof was subject at the date of his death to any change through the exercise of a power, either by the decedent alone or in conjunction with any person, to alter, amend, or revoke, or where the de-

cedent relinquished any such power in contemplation of his death, except in case of a bona fide sale for an adequate and full consideration in money or money's worth. Except in the case of transfers made after June 22, 1936, no interest of the decedent of which he has made a transfer shall be included in the gross estate under paragraph (1) unless it is includible under this paragraph;

(26 U. S. C., Sec. 811.)

* * * * *

Treasury Regulations 105, promulgated under the estate tax provisions of the Internal Revenue Code:

SEC. 81.15 *Transfers during life.*—The following classes of transfers made by the decedent prior to his death, whether in trust or otherwise, if not constituting bona fide sales for an adequate and full consideration in money or money's worth, are subject to the tax: * * * (5) transfers under which the enjoyment of the transferred property was subject at decedent's death to a change through the exercise, either by the decedent alone or in conjunction with another person or persons, of a power to alter, amend, revoke, or terminate, or where such a power was relinquished in contemplation of decedent's death (see sections 81.20 and 81.21).

* * * * *

SEC. 81.20. *Transfers with power to change the enjoyment.*—(a) *Transfers included.*—Subsection (d) of section 811 embraces a transfer by trust or otherwise (if not amounting to a bona fide sale for an adequate and full consideration in money

or money's worth) when at the time of decedent's death the enjoyment of the transferred property, or some part thereof or interest therein, was subject to any change through a power exercisable either by the decedent alone, or by him in conjunction with some other person or persons, to alter, or amend, or revoke, or terminate. (See section 81.15.)

The addition to subdivision (d) (1) of the Revenue Act of 1926, by section 805 of the Revenue Act of 1936, of the phrase to the effect that it is not material in what capacity the power was subject to exercise by the decedent or by the other person or persons in conjunction with the decedent (which phrase is also embodied in subsection (d) (1) of section 811 of the Internal Revenue Code), is considered merely declaratory of the meaning of the subdivision prior to the addition of the phrase.

The second phrase added to this subdivision of the Revenue Act of 1926 by amendment in 1936 (also embodied in section 811 (d) (1) of the Internal Revenue Code), namely, "without regard to when or from what source the decedent acquired such power," is not considered declaratory of the meaning of the subdivision prior to the amendment in a case in which no one of the powers enumerated in the subdivision was reserved at the time of the making of the transfer, but one or more thereof were conferred subsequent thereto (whatever the source from which conferred) without any understanding, expressed or implied, had in connection with the making of the transfer that such power or powers should be later conferred.

The third change made in the subdivision by the Revenue Act of 1936 (which is also embodied in subsection (d) (1) of section 811 of the Internal Revenue Code) consists of the addition of the words "or terminate" following the words "to alter, amend, revoke." Such addition is considered but declaratory of the meaning of the subdivision prior to the amendment. A power to terminate capable of being so exercised as to revest in the decedent the ownership of the transferred property or an interest therein, or as otherwise to inure to his benefit or the benefit of his estate, is, to that extent, the equivalent of a power to "revoke," and when otherwise so exercisable as to effect a change in the enjoyment, is the equivalent of a power to "alter."

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